PENNANT PETROLEUM LTD.

ANNUAL REPORT
1996

CORPORATE PROFILE

Pennant Petroleum Ltd., is a junior oil and gas company focused on the exploration and production of crude oil and natural gas properties in Western Canada. The shares of Pennant are listed for trading on the Alberta Stock Exchange under the symbol "PPL".

CORPORATE HISTORY

Pennant Petroleum Ltd. was incorporated on Febraury 10, 1995 pursuant to the provisions of the Business Corporations Act (Alberta). A public offering of securities was made under a prospectus dated April 20, 1995 and the common stock commenced trading July 4, 1995 on the Alberta Stock Exchange under the symbol "PPL". The Company became a fully listed junior oil and gas company on December 11, 1995 upon receiving shareholder approval of its major transaction at a special meeting held on November 17, 1995.

NOTICE OF ANNUAL GENERAL MEETING

The Annual General Meeting of Pennant Petroleum Ltd., will be held on June 12, 1997 at 11:00 A.M. in the Presidents Room of the Calgary Petroleum Club, 319 - 5th Avenue S.W., Calgary, Alberta.

ABBREVIATIONS

bbl	barrel	**boe**	barrel of oil equivalent
bopd	barrels of oil per day	**boed**	barrels of oil equivalent per day
mbbls	thousand barrels	**mboe**	thousand barrels of oil equivalent
mcf	thousand cubic feet	**mmboe**	million barrels of oil equivalent
mcfd	thousand cubic feet per day	**ARTC**	Alberta Royalty Tax Credit
mmcf	million cubic feet	**conversion**	10 mcf: 1 boe
mmcfd	million cubic feet per day	**EUB**	Alberta Energy And Utilities Board

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TO THE SHAREHOLDERS

1996 was an active year for Pennant Petroleum Ltd., as the Company participated in the drilling and completion of two wells in the Chestermere Alberta property and acquiring 38 properties from Aztec Resources Ltd., in addition to raising funds by private placement and flow-through share issues.

The operators application in November 1996 to the EUB for good production practise for the Chestermere project received final approval February 1, 1997. In this regard the Company is finally in a position to receive substantial revenue income from this project. However, at the time of this writing, production continues to be restricted by gas pipeline capacity which hopefully will be resolved shortly.

Effective November 1, 1996 the Company began receiving revenues from the properties acquired from Aztec. To date we are pleased with the revenue stream as we continue to enhance their value through further rationalization and increasing production by acquiring partner interests and tying in various shut-in projects.

Due to the fact the operator of the Chestermere property through no fault of its own did not receive EUB permission for good production practise at year end, the Company did not reach its predicted year end production exit forecast. The Company however, was producing 140 boed at the '96 year end. The Company's current production is now 180 boed and should increase to approximately 220 boed during the second quarter as we tie-in shut in production, which was recently acquired.

During the upcoming year, we look forward to developing additional cash flow which will enable the Company to participate in further production acquisitions, drilling ventures and possible mergers to further enhance share holder value.

We appreciate and thank our shareholders for their continued support.

On Behalf of the Board:

ORVAL K. HORN
PRESIDENT AND CHIEF EXECUTIVE OFFICER

HIGHLIGHTS

FINANCIAL

1. On July 5. 1996 the Company announced that it closed its fully subscribed flow-through share issue which raised $200,000 net to the Company with the issuance of 800,000 common shares at $0.25 per share, subject to a one year hold.

2. On November 15, 1996 the Company closed its fully subscribed private placement which raised $1,008,000 for the Company, with the issuance of 5.6 million common shares at $0.18 per share, subject to a one year hold.

OPERATIONS

1. The Company participated in the drilling of a well located on the Chestermere property namely 14-16-23-28 W4M which spudded March 30, 1996 and completed as an Elkton Zone oil well in which the Company retained a 6.5% working interest.

2. On June 26, 1996 the Company acquired a 100% working interest in a well known as Willgr 2-2-41-5 W5M for purposes of completing the Belly River zone. The well proved to be unproductive and the well has been abandoned.

3. The Company participated in the drilling of a fifth well on the Chestermere property, namely 6-20-23-28 W4M which spudded August 22, 1996 and completed as an Elkton Zone gas well in which the Company has a 6.5% working interest.

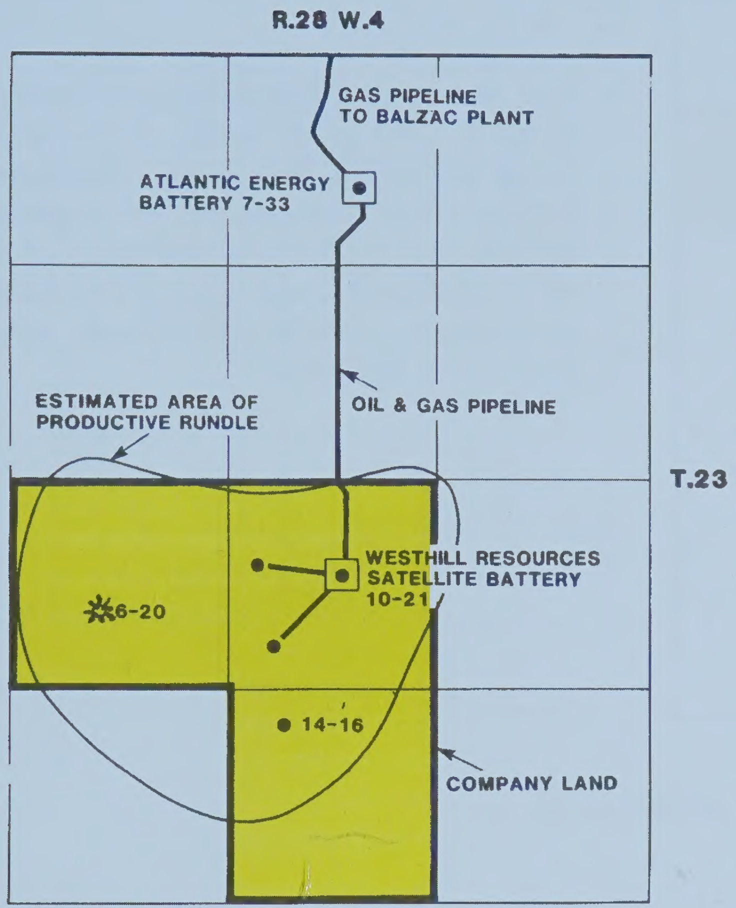
4. Application for good production practise was submitted to the Alberta Energy and Utilities Board early in November 1996. Approval was received February 1, 1997 and increased production of oil and gas is now occurring, however, the project is still restricted as to production capability because of limited gas pipeline capacity.

ACQUISITION

Effective November 1, 1996 Pennant acquired Aztec's interest in 38 minor working and royalty interest properties for a cash consideration of $1.2 million dollars. Proven plus probable reserves attributable to these properties totalled 93 mbbls. of oil and natural gas liquids and 3300 mmcf of natural gas with a pre-tax present worth value of $2,058,000 (15% discount) when using an escalated price forecast. Included in the sale were 19,721 gross acres and 3,046 net acres of undeveloped lands, with an appraised value of $127,951.

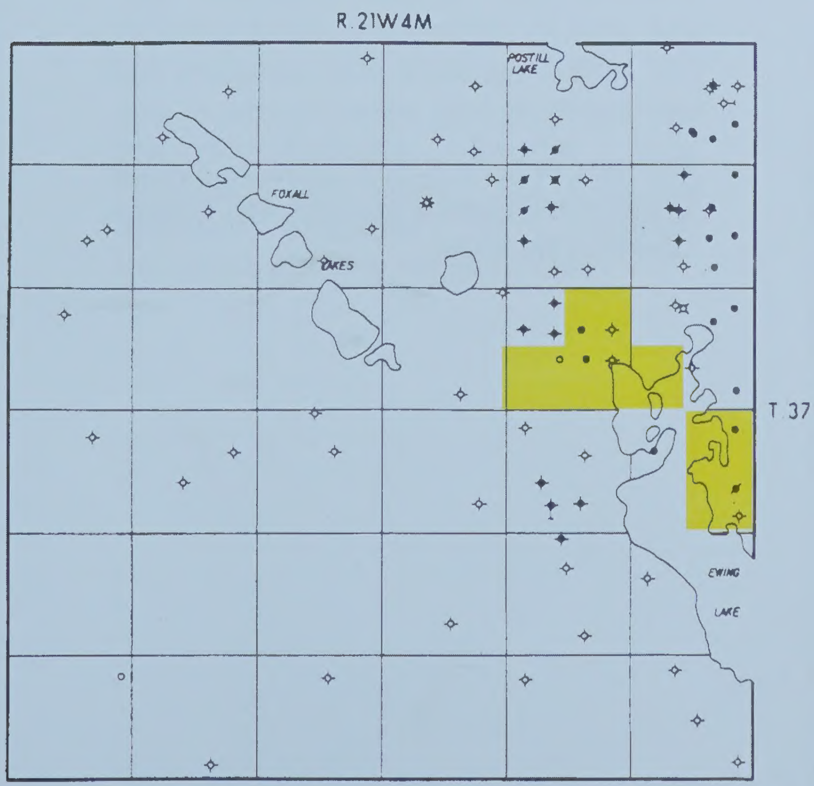
PRINCIPAL PRODUCING PROPERTIES

CHESTERMERE, ALBERTA



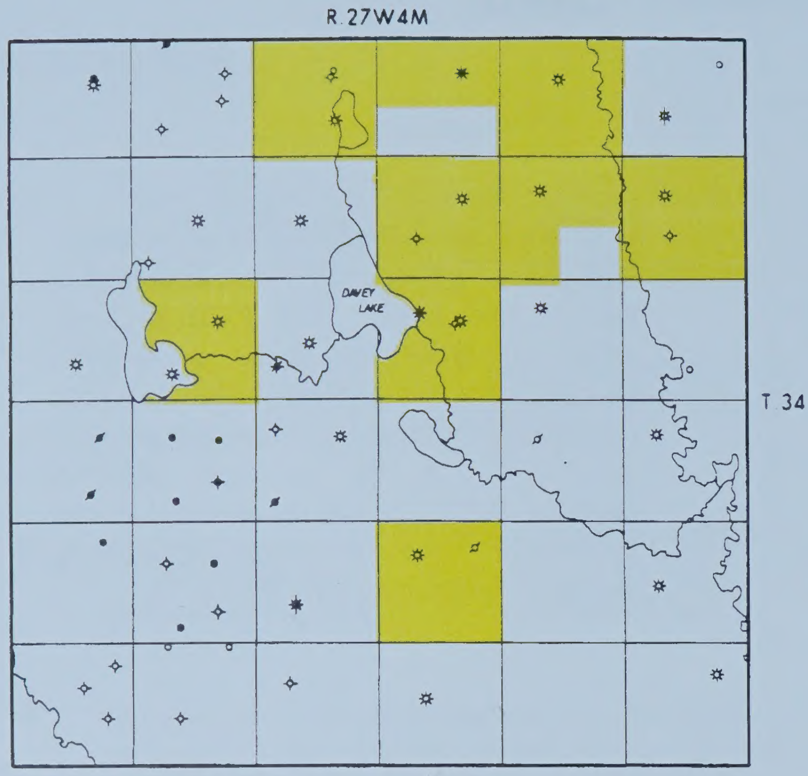
Pennant holds a 6.5% working interest in four producing wells and one shut in gas well in this area. The EUB recently approved GPP for these wells and commencing February 1, 1997 the wells are now producing at a maximum rate restricted only by our gas pipeline capacity, which should be resolved in the near term. The wells are operated by Westhill Resources Limited.

EWING LAKE, ALBERTA



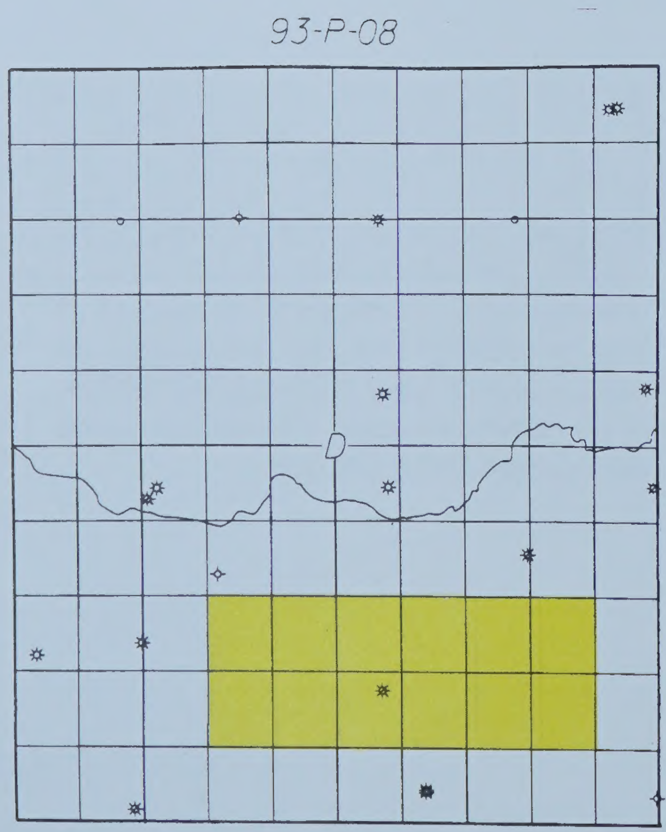
Pennant holds various working and GORR interests in 960 gross acres of non-operated oil property, consisting of five producing and one suspended oil well. Interest vary from 0.5% GORR to 14% working interest. The wells produce to a central battery facility.

DAVEY LAKE, ALBERTA



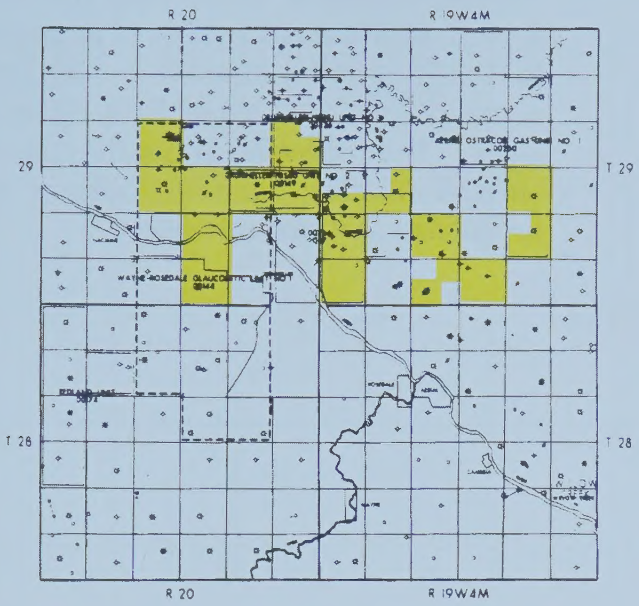
This non-operated natural gas property contains 5280 gross acres of land and seven producing gas wells. Facilities include a field gathering system, wellsite facilities and a 13.543% interest in an 8 mmcf/d refrigeration unit and a 5 mmcf/d compressor. Pennant's interests vary from 3.12% to 11.5%.

NOEL, BRITISH COLUMBIA



Pennant holds a 5.40% working interest in this non-operated gas well and facilities operated by Esso.

DRUMHELLER, ALBERTA



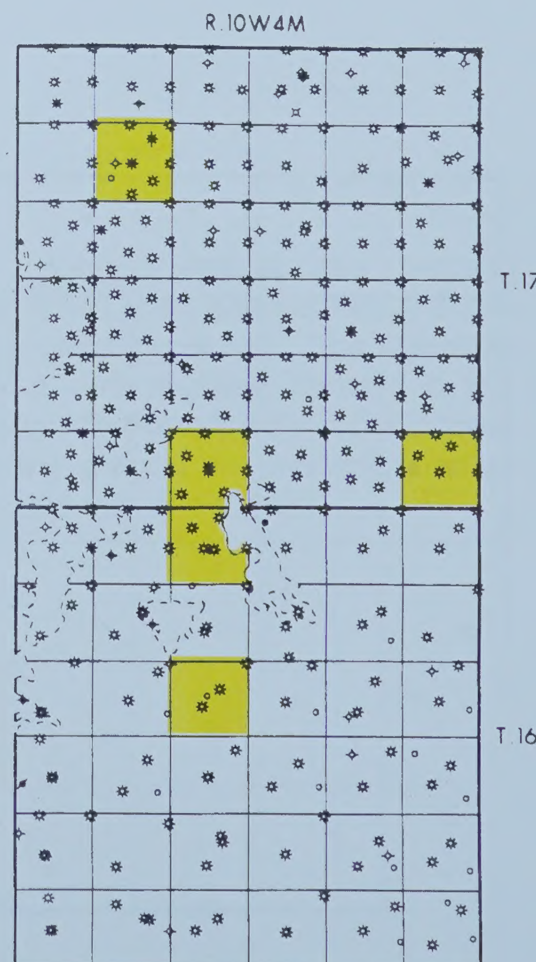
This non-operated oil and natural gas property includes royalty and working interests in a large acreage position and interests in the following units.

. Aerial Ostracod Gas Unit #1
. Drumheller Basal Quartz Gas Unit #1.
. Wayne Rosedale Glauconitic Unit #1.

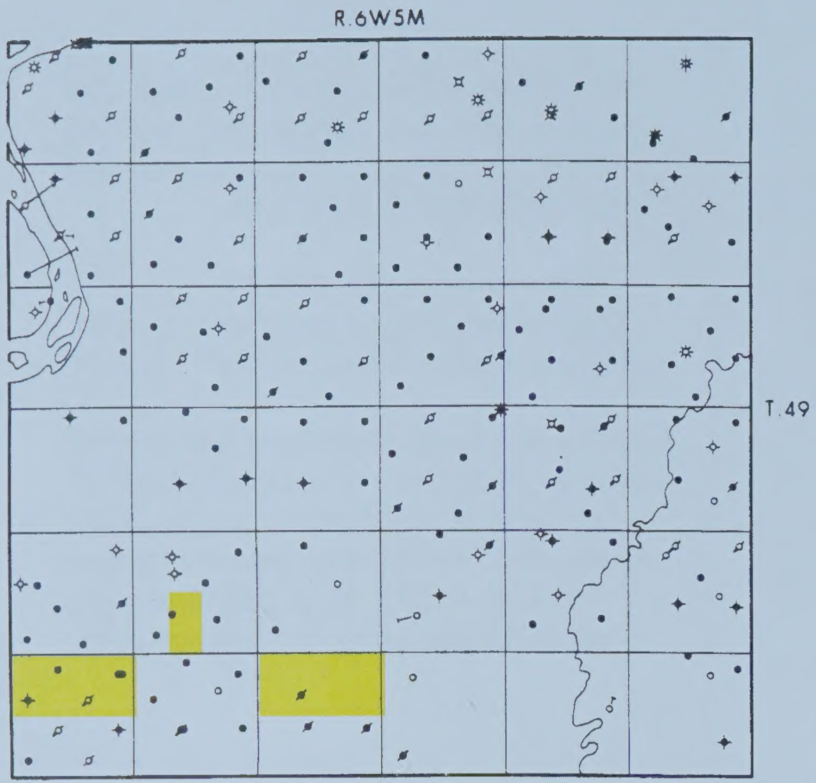
Three new wells have been drilled in the Wayne Rosedale Glauconitic Unit #1 resulting in a significant increase in unit production. Pennant's interest vary from a 0.3145% GORR to a 2.60% working interest in lands within the various units.

ALDERSON, ALBERTA

This operated natural gas property includes 3200 gross acres of land and two producing Belly River gas wells. The gas in uncontracted and is processed through Talisman Energy Inc's. Monogram Gas Plant. The wells are contract operated by Talisman. Pennant's working interest is 33%.

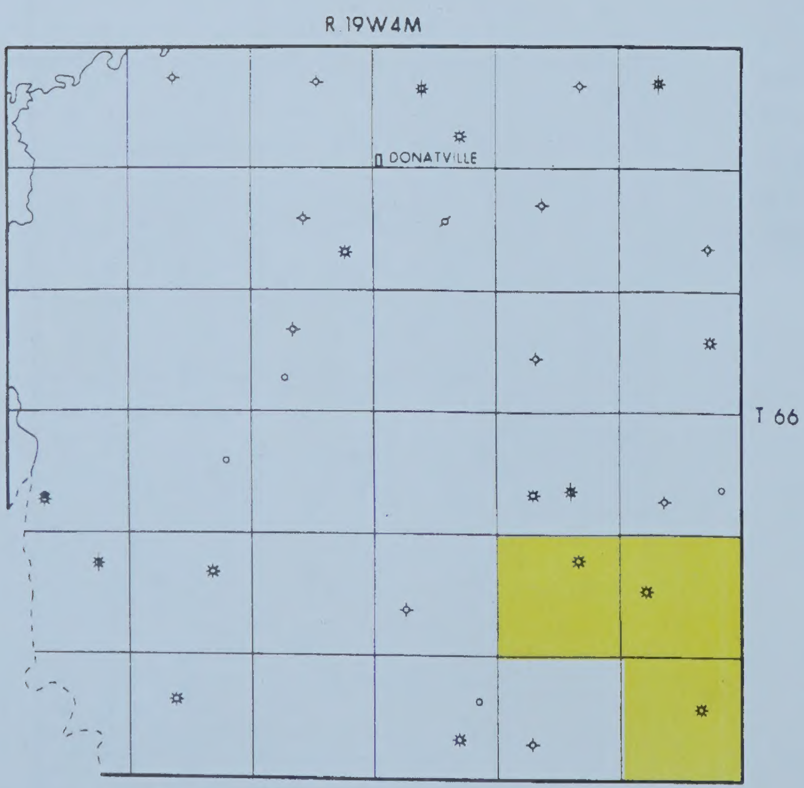


PEMBINA, ALBERTA



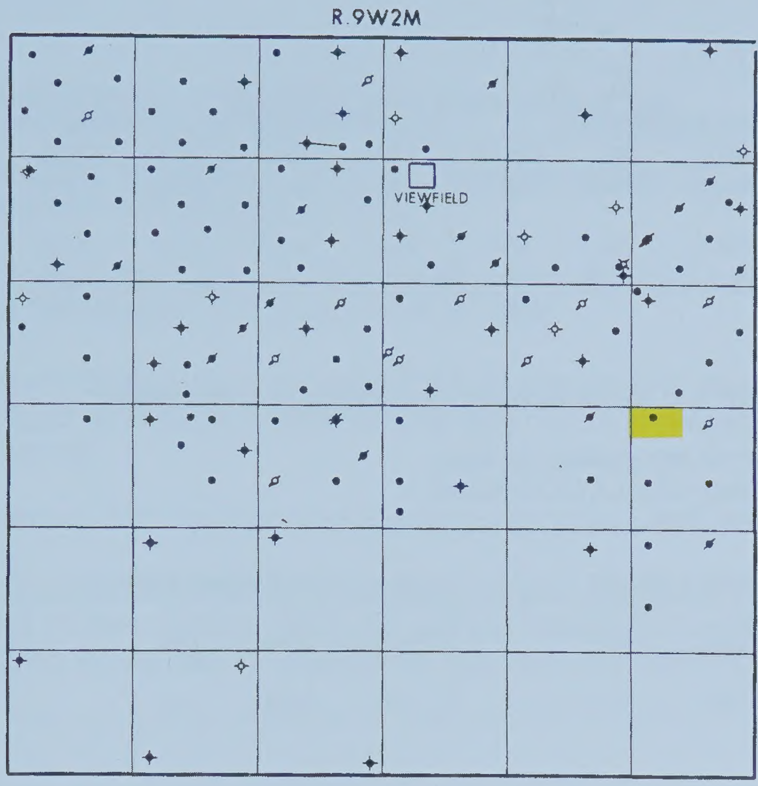
Pennant's interest varies from SS 1/150 5-15% GORR on 25 to 50% of production to 14.6% working interest in 720 gross acres of land and three Belly River oil wells. This operated property includes wellsite facilities, gathering system, and an interest in a central battery.

FLAT LAKE, ALBERTA



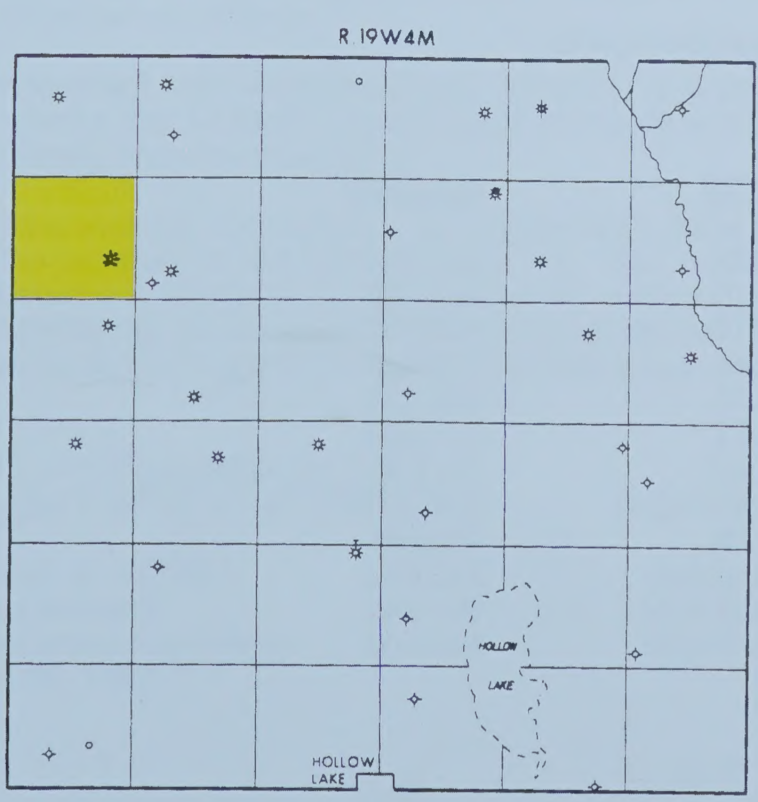
Pennant's interest varies from 13.02% to 39.0625% working interest in 1920 gross acres of land and three gas wells. Facilities include a field gathering system and wellsite facilities. The lands are contracted to TransCanada.

BENSON, SASKATCHEWAN



Pennant holds a 30% working interest in this operated oil property containing 80 gross acres of land and one producing Midale oil well.

NEWBROOK, ALBERTA



This operated natural gas property contains 640 gross acres of land and one shut-in Colony gas well. The Company holds a 50% working interest in this property which is currently in the process of being placed on production at an estimated rate of 1 mmcfd.

SUMMARY OF PROVEN AND PROBABLE RESERVES
AS OF DECEMBER 31, 1996

	W.I. PROVEN RESERVES				W.I. PROBABLE RESERVES				W.I. PROVEN PLUS PROBABLE RESERVES			
	OIL MBBLS	GAS MMCF	NGL MBBLS	EQUIV. MBOE	OIL MBBLS.	GAS MMCF	NGL MBBLS	EQUIV. MBOE	OIL MBBL.S	GAS MMCF	NGL MBBLS	EQUIV. MBOE
TOTAL:	97.0	2422.0	52.5	391.7	10.4	1757.4	8.6	194.8	107.4	4179.4	61.1	586.5

SUMMARY OF NET PRESENT VALUE OF PROVEN AND PROBABLE RESERVES

AS OF DECEMBER 31, 1996
USING ESCALATED PRICING

	PROVEN NPV $M			PROBABLE NPV $M			PROVEN PLUS PROBABLE NPV $M		
	UNDISC	10%	15%	UNDISC	10%	15%	UNDISC	10%	15%
TOTAL:	4807	3068	2600	1986	797	555	6793	3865	3155

SHARE TRADING DATA

MTH	HIGH	LOW	VOLUME
JAN '96	0.25	0.22	326,400
FEB '96	0.24	0.18	139,500
MAR '96	0.30	0.19	387,000
APR '96	0.33	0.23	290,000
MAY '96	0.40	0.23	390,000
JUN '96	0.44	0.21	241,000
JUL '96	0.29	0.23	29,500
AUG '96	0.25	0.18	154,520
SEP '96	0.23	0.19	78,000
OCT '96	0.25	0.18	142,500
NOV '96	0.30	0.20	461,540
DEC '96	0.35	0.23	153,500

MANAGEMENT'S DISCUSSION AND ANALYSIS

Pennant's cash flow for the year ended December 31, 1996 was $60,490 compared to a ($4,695) loss during our start up year in 1995.

Production revenues net of royalties were $247,774 combined with other income of $1,617 totalled $249,391 compared with $17,418 in 1995.

Production expenses averaged $7.04 per boe for the year ended December 31, 1996. Oil prices averaged $27.50 per barrel, natural gas prices averaged $1.49 per mcf and natural gas liquids $21.45 per barrel.

Depletion, depreciation and site restoration was $89,800 for the period ended December 31, 1996.

Pennant's cash flow for the upcoming year will come from the production acquisition which Pennant closed on November 1, 1996, its working interest in the Chestermere property and two shut in gas wells currently being tied in. Estimated cash flow for 1997 is $650,000 or $0.043 per share.

MANAGEMENT'S REPORT TO THE SHAREHOLDERS

Management is responsible for the preparation and presentation of the accompanying financial statements and for ensuring that all other financial and operating information presented is consistent with the financial statements.

Management has established and maintains a system of internal controls to provide reasonable assurance that all assets are managed efficiently and to facilitate the preparation of relevant, reliable and timely financial information.

External auditors, appointed by the shareholders, have examined the financial statements. The report of the auditors is set forth on page 11. The Audit Committee, consisting of a majority of non-management directors, is responsible for overseeing the financial reporting process. The Audit Committee has reviewed the financial statements with management and the external auditors and has reported to the Board of Directors. The Board had approved the financial statements.

ORVAL K. HORN President and Chief Executive Officer April 18, 1997	VINCENT J. TKACHYK Vice President and Chief Financial Officer

KPMG

KPMG
Chartered Accountants

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AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the balance sheets of Pennant Petroleum Ltd. as at December 31, 1996 and 1995 and the statements of operations and deficit and changes in financial position for the year ended December 31, 1996 and the period from the date of incorporation on February 10, 1995 to December 31, 1995. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the year ended December 31, 1996 and the period from the date of incorporation on February 10, 1995 to December 31, 1995 in accordance with generally accepted accounting principles.

KPMG
Chartered Accountants

Calgary, Canada
March 28, 1997

PENNANT PETROLEUM LTD.

Balance Sheets

December 31, 1996 and 1995

	1996	1995
Assets		
Current assets:		
Cash and term deposits	$ 191,493	$ 556,310
Accounts receivable	87,382	3,984
Prepaid expenses	4,170	–
	283,045	560,294
Property and equipment		
Petroleum and natural gas properties	2,516,822	424,042
Less accumulated depletion and depreciation	(78,300)	–
	2,438,522	424,042
	$ 2,721,567	$ 984,336
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 28,570	$ 261,429
Current portion bank loan (note 2)	126,000	–
	154,570	261,429
Bank loan (note 2)	374,000	–
Provision for site restoration	11,500	–
Shareholders' equity:		
Capital stock (note 3)	2,215,502	727,602
Deficit	(34,005)	(4,695)
	2,181,497	722,907
	$ 2,721,567	$ 984,336

See accompanying notes to financial statements.

On behalf of the Board:

Director

Vincent J. [illegible]

Director

PENNANT PETROLEUM LTD.

Statement of Operations and Deficit

Years ended December 31, 1996 and 1995

	1996	1995
Revenue:		
Petroleum and natural gas	$ 320,398	$ –
Royalties, net of ARTC	(72,624)	–
	247,774	–
Other income	1,617	17,418
	249,391	17,418
Expenses:		
Operating	107,764	–
General and administrative	78,737	22,113
Interest on bank loan	2,400	–
Depletion and depreciation	78,300	–
Site restoration	11,500	–
	278,701	22,113
Loss	(29,310)	(4,695)
Deficit, beginning of year	(4,695)	–
Deficit, end of year	$ (34,005)	$ (4,695)
Loss per share	$ –	$ –

See accompanying notes to financial statements.

PENNANT PETROLEUM LTD.

Statement of Changes in Financial Position

Years ended December 31, 1996 and 1995

	1996	1995
Cash provided by (used in):		
Operations:		
Loss	$ (29,310)	$ (4,695)
Items not involving cash:		
Depletion and depreciation	78,300	–
Site restoration	11,500	–
	60,490	(4,695)
Change in non-cash working captial	(320,427)	257,445
	(259,937)	252,750
Financing:		
Issuance of common shares	1,487,900	727,602
Bank borrowings	500,000	–
	1,987,900	727,602
Investments:		
Property and equipment additions	(801,111)	–
Property acquisitions	(1,291,669)	(424,042)
	(2,092,780)	(424,042)
Increase (decrease) in cash	(364,817)	556,310
Cash, beginning of year	556,310	–
Cash, end of year	$ 191,493	$ 556,310

Cash is defined as cash and term deposits.

See accompanying notes to financial statements.

Incorporation:

Pennant Petroleum Ltd. was incorporated as 642672 Alberta Ltd. by Certificate of Incorporation issued pursuant to the provisions of the Business Corporations Act (Alberta) on February 10, 1995. The name of the Corporation was changed to Pennant Petroleum Ltd. by certificate of amendment dated March 14, 1995.

1. Significant accounting policies:

(a) Joint venture accounting:

All of the Company's exploration, development and production activities are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

(b) Oil and gas operations:

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas reserves are capitalized. Such costs include land acquisition costs, geological and geophysical expenses, carrying charges on non-producing properties and the costs of drilling both productive and non-productive wells.

The costs, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated proven reserves. Oil and gas reserves and production are converted into equivalent units based upon estimated relative energy content.

Costs of acquiring and evaluating unproven properties are initially excluded from depletion calculations. These unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or when the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion calculations.

The capitalized costs less accumulated depletion and depreciation, deferred income taxes and the provision for future site restoration costs are limited to an amount equal to the estimated future net revenue from the estimated proven reserves (based on prices and costs at the balance sheet date) plus the cost (net of impairments) of unproven properties less estimated future site restoration costs, general and administrative expenses, financing costs and income taxes.

Estimated future site restoration costs are provided on the unit-of-production method based on the estimated proven reserves. Estimated costs are based on engineering estimates in accordance with current legislation and industry practices. The annual charge is recorded as additional depletion and depreciation. Actual expenditures are charged to the accumulated provision account as incurred.

Proceeds from the sale of oil and gas properties will be applied against capitalized costs, with no gain or loss recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

2. Bank loan:

	1996	1995
Principal	$ 500,000	$ –
Less: current portion	(126,000)	–
	$ 374,000	$ –

The bank loan is a non-revolving demand loan, which bears interest at prime plus 1%. Principal is repayable at $10,500 per month, commencing January 1, 1997. The loan is secured by a debenture carrying a fixed and floating charge on all of the Company's assets.

3. Capital stock:

Authorized:

Unlimited number of common voting shares without nominal or par value.

Issued:

	Number of shares	Consideration
On incorporation (i)	1,500,000	$ 75,000
Public offering	4,250,000	425,000
Flow-through shares (ii)	1,220,000	305,000
Exercise of underwriter's options	212,500	21,250
Major transaction (iii)	1,375,000	275,000
Less: Escrow shares on major transaction (iii)		(275,000)
Share issue costs		(98,648)
Balance, December 31, 1995	8,557,500	727,602
Exercise of underwriter's options	142,015	14,202
Flow-through shares (ii)	800,000	200,000
Private placement for cash	5,600,000	1,008,000
Escrow shares on major transaction (iii)		275,000
Less: Share issue costs		(9,302)
Balance, December 31, 1996	15,099,515	$ 2,215,502

(i) At December 31, 1996, 1,000,000 shares issued on incorporation remain in escrow. Upon the written consent of the Chief of Securities Administration of the Alberta Securities Commission, one-third of the original number of shares will be released on each anniversary of the completion of the major transaction.

(ii) During the year ended December 31, 1996 the Company issued 800,000 (1995 - 1,220,000) flow-through shares for cash consideration of $200,000 (1995 - $305,000). The Company renounces the qualifying expenditures made from the proceeds of these issue to the purchasers of these shares.

(iii) On December 11, 1995 the shareholders approved a major transaction to purchase certain oil and gas interests from private corporations controlled by two directors of the Company in exchange for $150,000 and 1,375,000 common shares at $0.20 per share. The shares issued were placed in escrow. The escrow agreement allows for the release of these shares as follows:

- one common share to be released for each $0.20 of cumulative cash flow generated by the reserves that were classified as probable on December 31, 1995; or
- one common share to be released for each $0.20 of proved producing value which an independent engineering report indicates resulted from reserves classified as probable on December 31, 1995.

The maximum number of escrowed shares to be released in any one year is one-third of the original number of shares subject to the escrow agreement. At December 31, 1995 it could not be reasonably determined the number of shares that would ultimately be released from escrow. In December 1996, with the delivery of an independent engineering report, the Company received approval for the ultimate release of 1,375,000 common shares. As a result, the value of the shares issued on the transaction was recorded as an addition to capital stock and property and equipment in December 1996. At December 31, 1996, 916,666 of the shares issued on the transaction remain in escrow to be released in 1997 and 1998.

Reserved for issue:

At December 31, 1996 the Company had reserved 855,750 (1995 - 630,000) common shares for issue under a stock option plan at prices varying from $0.10 per share to $0.20 per share. The options are exerciseable from time to time prior to May 7, 2001.

At December 31, 1996 the Company had reserved 70,485 (1995 - 212,500) common shares for issue to an underwriter at a price of $0.10 per share. Subsequent to December 31, 1996 the options were exercised.

4. Income taxes:

At December 31, 1996 property and equipment with a net book value of $488,300 (1995 - $202,500) is not deductible for income tax purposes.

CORPORATE INFORMATION

HEAD OFFICE

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OFFICERS

Orval K. Horn
President and Chief Executive Officer

Vincent J. Tkachyk, P.Eng.
Vice President and Chief Financial Officer

Kari F. Horn
Corporate Secretary

BOARD OF DIRECTORS

Orval K. Horn
Calgary, Alberta

Vincent J. Tkachyk, P.Eng.
Calgary, Alberta

William J. Rodgers, P.Geol.
Calgary, Alberta

John S. Rodgers
Calgary, Alberta

SOLICITORS

Blake, Cassels and Graydon
Calgary, Alberta

AUDITORS

KPMG
Calgary, Alberta

TRANSFER AGENT

The Montreal Trust Company of Canada
Calgary, Alberta

BANKER

Hongkong Bank of Canada
Calgary, Alberta

STOCK EXCHANGE LISTING

The Alberta Stock Exchange
Symbol: PPL

PENNANT PETROLEUM LTD.

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